Networth News

State of Utah, Department of Financial Institutions, First Quarter 2004

Commissioner's Comments

G. Edward Leary, Commissioner

PREEMPTION is one of the many words that we see often in today's banking news. Many of you may be struggling with questions of what does the term mean and why is it so important? At the risk of causing more confusion, let me try and explain why the issue is important to the Department.

Preemption came to the attention of all most recently on January 8, 2004 when the Comptroller of the Currency ("OCC") issued broad regulations that took effect on February 12, 2004, that preempt almost all state consumer protection laws that apply to national banks and their operating subsidiaries. National

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Chiefly Speaking

Michael Jones, Chief Examiner

In the First Quarter 2003's Networth News, I discussed two new annual assessment payment alternatives the Department was initiating on July 1, 2003: wire transfers and automated clearings (ACHs). Having completed the annual assessment cycle, this is a good time for some follow-up on successes and problems noted in receiving electronic payments, and to provide an update for the upcoming assessment cycle.

In July, the Department mailed 225 notices, representing $3,620,126 in billings, for the 2003 annual assessments. These notices were sent to active and inactive state-chartered banks, credit unions, industrial banks, savings and loan associations, and trust companies. They were also sent to independent escrow companies and third-party payment providers with operations in Utah, out-of-state depository institutions with loan production office in Utah, and those companies who are the parent company of state-chartered depository institutions.

By the end of September, we completed our collection of the 2003 assessments. For the first year of receiving electronic payments, the use of wire transfers and ACHs was better than expected. Over 47 percent of the annual assessment's total dollar volume was paid by way of an electronic payment. Wire transfers were selected by 65 percent of the entities who submitted their payment electronically, while 35 percent used an ACH as their preferred alterative payment choice. Use of these electronic payment options was widely accepted, ranging from the Department's largest assessment ($1.3 million) to the smallest assessment

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Inside This Issue

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Banks have, by right of their charter, preempted many state laws and powers. What dramatically altered the landscape was the OCC extending that preemption power, not by legislative power, but by rule, to operating subsidiaries.

These rules could have profound implications for the current balance in the dual banking system, and the application and enforcement of consumer protections in the states. The OCC issued final rules in the following areas:

> Visitorial Rights - essentially prohibiting any and all state authority over nationally chartered banks including oversight by state attorney generals for the national bank AND their operating subsidiaries and agency relationships (state corporations that are often licensed and regulated by the states).
>
> Preemption Authority - moving from an analysis of whether or not a law conflicts with a state law, or "prevents or significantly interferes" with the operation of a national bank, to one where the National Bank Act sweeps aside virtually all state laws that even condition an activity of a national bank unless otherwise noted by the OCC for both the national bank AND its operating subsidiaries.
>
> New National Non-Depository Corporate Charter - an attempt to create a non-bank national bank that has all the rights and preemptive authority of a national bank but is not a national bank. In essence, a national bank could spin off a portion of its operation (a mortgage department) and that new entity, although it does not qualify as a national bank under the National Bank Act, could continue to operate as if it were a national bank, keeping all of the rights and privileges (including preemption of state law).

States have responded expressing serious concern over these dramatic changes and their potential impact on the dual banking system. The National Governors' Association ("NGA"), the National Association of Attorneys General ("NAAG"), the National Conference of State Legislatures ("NCSL") and the Department's association, the Conference of State Banker Supervisors ("CSBS") have all opposed these rules.

Why have we done so?

> Wholesale preemption of state laws and state oversight threatens to undermine the integrity of the dual banking system and moves toward a centralized regulatory model that would severely weaken the ability of states to respond to local economic needs. (CSBS)
>
> The OCC's preemption analysis is one-sided and self-serving. The OCC has paid little deference to well established history and precedent that has allowed the States and the OCC to coexist in a dual regulatory role for over 130 years. (NAAG signed individually by all 50 state Attorneys General)
>
> The Governors are uncomfortable with any proposed rulemaking that would so remarkably concentrate regulatory power. (NGA)
>
> The proposal should be withdrawn and a thorough review take place to determine the potential far-reaching implications that would result from such a radical change to the nation's banking system. (NCSL)

(Comment Letters, Correspondence, Press Release, etc. can be found at:

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www.csbs.org/government/leg_affairs.asp#fedpreemtion)

This new regulation also shields national banks and their subsidiaries from oversight, licensing, inspection, and enforcement actions by any state authority, including the state attorney general. In effect, the OCC decreed that state laws designed to protect consumers from such actions as predatory lending, fraud, and other abuses are null and void for national banks that operate in your state. The OCC regulations exempt mortgage banks and mortgage brokers, finance companies, title companies, leasing companies - *if* these companies are structured to be subsidiaries of a national bank.

In response to the actions of many, including the state associations listed above, the House Financial Services Committee, on February 25, 2004, voted 34-28 to criticize the OCC for taking on the solitary role of policing national banks. These national banks handle roughly half of the banking public without adding significant resources. However, the vote does not repeal the regulation.

The Comptroller of Currency's move is bad news for consumers. In the last decade, as the banking industry has consolidated, banks have dramatically expanded the array of financial services they provide, particularly through their non-bank operations. The OCC action means growing numbers of consumers won't be able to count on state laws or law enforcement to protect them.

As the role of financial institutions has expanded in recent years, they developed a wide range of new products and services. They may provide more options for consumers, but these new services also create new opportunities for confusion and, in some cases, abuse. Some states have attacked the problems they have experienced by adopting regulation or passing legislation, and financial education campaigns that have reached thousands of borrowers and potential borrowers. Generally, a consumer's first response, if they have a question or believe they have been "ripped off", would be to contact state authorities. However, under the OCC's preemption rule, the state can do nothing but refer the victim to the OCC's call center in Houston.

The OCC's move takes power away from those most responsive to consumers' needs — state regulators. States are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens. States are much better equipped than the federal government to respond quickly and to tailor solutions to the specific needs of consumers and industry.

Yes, an argument may be articulated that states and municipalities may have brought this problem on themselves by passing many non-standard laws and rules to deal with problems like predatory lending. But the way to make those changes is for government officials closest to the people — state legislators and Congress — to hold hearings, listen to debates, and set public policy.

In summary, I relate to what Delaware State Rep. Donna Stone, NCSL's Financial Services Chair recently said in Washington, D.C. as reported in BANKNEWS December 2003:

> *Rep. Stone noted that the financial services marketplace is changing, with great emphasis on speed, synergy, economies of scale and ever-increasing efficiencies. "Somehow - here inside the Capital Beltway - the changing marketplace is translating into calls for centralized regulatory control and*

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federal preemption," she said. "It shouldn't surprise you," she added, "that as a representative of the nation's state legislatures, I believe the push to federalize financial regulation is a tremendous mistake."

It's well understood, she indicated, that states more effectively protect consumers and respond to financial problems and concerns that are local or regional in nature. But the value of state regulation goes well beyond consumer protection, she added.

"State regulation plays a vital role in making the U. S. financial markets the strongest and most dynamic in the world," she said. "The dual banking system promotes a decentralized banking structure that spreads capital evenly across the economy."

There's no question. Rep. Stone told her Washington audience that state and federal regulation must adopt to keep up with the changing marketplace, and there is no question that the balance between state and federal regulation works - for consumers, financial markets and the U. S. economy as a whole.

Financial services regulation is not easy, Rep. Stone conceded, and it's a task made more difficult by a rapidly changing marketplace. However, the right answers to the challenge are not centralized federal control or preemption.

"Instead, state legislatures believe that we must build on the current systems of financial regulation to strengthen - rather than weaken - the state-federal partnership," she concluded. "This partnership has been a vital element in the strength and vitality of America's financial marketplace. Not only is it worth preserving, but it is the foundation on which we will build our future success."~

2004 Bank Directors' Seminar

October 7 to 9, 2004
Coeur d'Alene Resort/Coeur d'Alene, Idaho

The Graduate School of Banking at Colorado, in conjunction with the Conference of State Bank Supervisors, presents the 2004 CSBS Bank Directors' Seminar.

The program provides valuable bank director training, including clear and effective tools to assist individuals to serve as community bank directors.

Key Note Presentations include:

- What's on the Mind of Your Regulator?
- Risk and Reward of Current Financial Strategies.
- Effectively Implementing Corporate Governance.

Small Group Sessions include:

- Board Committee Structure and Function.
- Bank Financial Analysis.
- Credit Evaluation.
- Interest Rate Risk.
- Strategy to Practice – Simulating a Banking Environment.
- What to Watch for in Key Regulations.

<u>To learn more or to register:</u>

go online at registrar@csbs.org

or call 800-886-2727

Application Activity Report

Utah Department of Financial Institutions

For quarter ending March 31, 2004

Branch Approval	**Address**	**Received**	**Status**
Treasury Credit Union	145 East 23rd Street, Ogden UT	8/8/03	Opened 1/26/04
Credit Union One	1773 West North Temple, SLC UT	11/7/03	Opened 2/6/04
Far West Bank	822 S SR 198, Payson UT	12/12/03	Approved 1/8/04
Moroni Feed Credit Union	420 S Main, Gunnison UT	1/30/04	Approved 2/3/04

Shared Branches	**Address**	**Received**	**Status**
Utah Central Credit Union	4163 Riverdale Road, Ogden UT	12/31/03	Opened 1/6/04
Health Care Credit Union	all locations	1/27/04	Opened 2/27/04
Member's First Credit Union	all locations	2/4/04	Opened 2/27/04

Branch Discontinuance	**Address**	**Received**	**Status**
Centennial Bank	534 Harrisville Rd, Ogden UT	12/11/03	Closed 2/19/04
Centennial Bank	1550 N Main, Logan UT	12/11/03	Closed 2/19/04
Centennial Bank	1355 S Sawhill Rd, Orem UT	12/11/03	Closed 2/19/04
Centennial Bank	660 S 1750 W, Springville UT	12/11/03	Closed 2/19/04

Relocations	**Address**	**Received**	**Status**
Health Care Credit Union	from Central Office to 36 S State, SLC	1/27/04	Approved 2/24/04
America West Bank	from 1010 N Hillfield Rd, Layton to 476 W Heritage Blvd, Layton	3/19/04	Accepted 3/22/04

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De Novo Charter	Address	Received	Status
Goldman Sachs Bank USA	295 Chipeta Way Salt Lake City UT	7/3/02	FDIC Approved 7/21/03 Extended on 3/3/04
Target Bank	299 S Main Suite 1300 Salt Lake City UT	12/31/03	Accepted 12/31/03 Time suspended 3/9/04
GMAC Automotive Bank		2/13/04	

Field of Membership Expansion	Amend Bylaws to Include	Received	Status
Beehive Credit Union	to add employees of Name Tag, Inc	1/29/04	Approved 2/19/04
Moroni Feed Credit Union	to add residents of Sevier County	12/26/03	Approved 2/3/04
Premier Services Credit Union	to add employees of Utah AG's office	1/15/04	Approved 2/19/04
Credit Union One	to add employees of Modern Display	3/4/04	Accepted 3/5/04
Treasury Credit Union	to add employees of Junction City Café	3/5/04	Accepted 3/12/04

Mergers or Acquisitions	Received	Status
American Investment Financial into American Investment Bank, NA	1/9/04	Approved 2/18/04

Loan Production Office (LPO)	Address	Received	Status
Centennial Bank	270 ½ N Main, Logan UT	1/23/04	Opened 2/24/04
Washington Trust Bank	486 W 50 N, American Fork UT	1/26/04	Opened 2/12/04

The New Large Bank Challenge

Jim Thomas, Supervisor of Banks

For the last two decades large banks have tried to sustain their growth through merger and acquisition of small community Banks. For a period the large banks experimented with various forms of self-service banking like internet banking, and ATMs. They have experimented with in-store branches and kiosks. They tried reducing the number of employees they used and they closed many branches in an effort to become efficient. For the most part, the large bank schemes have failed to reach the same level of growth as community banks. This has caused the large banks to re-think their strategies.

New Challenges for Community Banks

It appears that the new strategy of large banks is to grow the old fashioned way through branching, improved personal contact in order to grow their account relationships one at a time. They have realized by using good demographic studies, they can place branches in high growth areas, hire local management and staff away from established community banks and meet their growth targets. For community banks located in these high growth areas this will be a new experience. These large bank branches will be there trying to look very much like a community bank. They will be using former community bank employees. They will be housed in newer facilities using newer and improved equipment. And, they will have huge advertising budgets.

Advice for Community Banks

Stay calm! You have the advantage. They are trying to play your game, on your turf. They may have better facilities; more advertising, better equipment, and they may even have some of your former employees. But, they have one other thing that you don't. They will have a very well defined period of time to prove that they can be successful in reaching their growth goals. If they fail to reach their projections in the first 24 to 36 months they will be closed or loose their support for becoming a major player in their market area.

Here are some recommendations to improve how well you compete as a community bank:

- ***Price loans according to risk***: This means that every borrower does not get the bank's best rate.
- ***Staffing levels should be appropriate***: Face to face contact with customers pays huge dividends and has been the strength of community banks. Employees, however, should not be sitting idle.
- ***Tiered Deposit Pricing:*** Small balance accounts are at your bank for convenience not for the interest paid on them. Large balance accounts, on the other hand, may move away due to a rate differential.
- ***Retain Human Resources:*** Your employees are the first line of defense to a large bank's intrusion. Your employees are what you have that they would like to have. In addition, it is expensive to train new employees.
- ***Performance based pay:*** It is obviously unwise to pay large production incentives to originate poor quality loans. Various forms of production incentives have proven to create a sense of belonging to the company, and generally motivate employees to do better and more work.
- ***Non-interest income:*** With the interest rate margin razor thin, effective banks must charge for service rendered. More profitable banks search for new services on which they can assess fees.
- ***Know your bank's strengths:***

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billed ($100). Those choosing to pay their assessment electronically included banks, credit unions, industrial banks, and holding companies, as well as a couple of entities holding inactive charters.

Use of electronic payments was also a success for the Department. Between the wire transfers and the ACHs, we had approximately 8 percent fewer checks to deposit. With each wire transfer, we received a confirmation from our depository institution within 2 or 3 days notifying us that a transfer had been made and who had initiated the transfer. Notifications of the ACHs took a little longer, appearing on our monthly statements. Documentation, however, for either method of electronic payment was sufficient enough that the Department was able to determine payments were properly posted and from whom the payments were received.

I thank those who used a wire transfer or an ACH to pay their annual assessment this past year. It was a good beginning toward accepting and posting electronic payments. Those problems encountered receiving wire transfers and ACHs were easily resolved. Having received a follow-up e-mail message from someone in a state-chartered institution or regulated entity provided the Department a way of cross-checking our deposit statement and resolving uncertainties. Few telephone calls, following-up on and resolving payment problems, were necessary.

With the wide acceptance and use of electronic payments in 2003, we will continue to offer these alternative payment options this coming year, and expect to extend its availability to those financial entities that pay the Department an annual registration fee. Wire transfers and ACHs have proven to be good options for those who pay annual assessments. Meanwhile, we continue to explore the possibilities of accepting payments by credit card, debit card, and/or electronic check.

Look for instructions to once again be sent with the invoices mailed on July 1, 2004. Until then, if you are interested in the possibility of paying your 2004 assessment electronically, and would like more information, let me know. I can be reached by telephone at (801) 538-8836 or by e-mail at mjones@utah.gov.~

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- Take time to assess the reasons your present customers bank with you. Consider both individual and business accounts.
- Take time to assess how well your bank satisfies those reasons. If you are doing so-so, or poorly, correct the problem.
- Evaluate how your bank compares to the competition. In the areas your bank is inferior, determine what can be done to make it superior.
- Develop methods for letting existing and prospective customers know that you possess superior abilities to satisfy their banking needs.

Conclusion

It has taken large banks a long time to realize what community bankers have known all along. Large banks will try to invade the community bank's turf. When they do, stay cool. Continue doing those things you do well; determine what things you do less well and improve on them.~

Commissioner Leary and Darryle Rude, Supervisor of Industrial Banks, traveled to Washington, D.C. March 24-25 to take part in a series of bank regulatory meetings organized by the Conference of State Bank Supervisors (CSBS).

Commissioner Leary and Mr. Rude discussed myriad issues currently facing the nation's banking industry, such as payday lending, predatory lending, privacy, interstate banking and federal preemption of state banking laws. Federal preemption of state banking laws topped this year's agenda.

Delegates kept to a full schedule from noon Wednesday to noon Thursday with policy briefings and visits with members of Congress. The program featured a two-hour legislative briefing Wednesday afternoon, followed by a one-hour dialogue with Federal Reserve Chairman Alan Greenspan. Later Wednesday evening, delegates gathered at the Supreme Court, for a reception/dinner, with Justice Sandra Day O'Connor. Thursday morning, delegates met with House Financial Services Committee Chairman Michael Oxley (R-Ohio) and the Committee's Ranking Minority Member Barney Frank (D-Mass.), followed by a dialogue with Senate Banking Committee Ranking Member Paul Sarbanes (D-Md.) and a briefing by Ron Crump, Senior Counsel and Investigator for the Senate Select Committee on Aging, which recently held an oversight hearing on how state and federal governments combat predatory lending as it affects the elderly. Thursday afternoon, state commissioners met with their respective Congressional representatives to discuss the preemption issue.

The program is held annually as a way for state banking regulators to communicate their positions on current issues impacting the nation's banking system. Sixty-one state bank regulators from 35 states participated in this year's fly-in.

2004 Legislative Update
Paul Allred, Deputy Commissioner

Once again, it is that time to provide our annual Legislative Update. The Utah Legislature passed 419 bills during the 2004 General Session. This article will briefly review 3 bills that will impact financial institutions and other entities under the jurisdiction of the Department of Financial Institutions (DFI).

SB 176 - FINANCIAL INSTITUTIONS AMENDMENTS

Senate Bill 176 authorizes all industrial banks and those commercial and savings banks that are Sub S corporations to convert to Limited Liability Companies (LLCs). However, a change of tax status may only occur once the IRS approves banks for LLC status, which is expected. The drafting required changing Industrial Loan Corporation (ILC) to Industrial Loan Company everywhere it occurs in the Code. DFI took advantage of this fact to make a change to Industrial Banks instead of ILC.

2nd SUB. SB 47 - UNIFORM TRUST CODE

This bill adopts the "Uniform Trust Code". Modifications were needed to preserve the benefits of H.B. 299 from the 2003 session. Senator Hillyard asked the office of Legislative Research and General Counsel to "draft" around H.B. 299. However, the banking industry felt that some amendments were necessary. Senator Hillyard approved a compromise between the Trust Section of the Bar and the banking industry, and the bill was passed as amended.

HB 192 - REPEAL OF THRIFTS SETTLEMENT FINANCING

House Bill 192 repeals Chapter 21 of Title 7. The Act was created as part of the settlement with the class of citizens who had money in the thrifts. All claims have been closed. As a result, this is a good housekeeping measure to repeal.

A MATTER FOR CONCERN

Finally, the Department would like to make our readers aware of HB 102. House Bill 102 did not pass during the 2004 session. Sponsored by Representative Hutchings, as written, HB 102 proposed to require <u>all</u> mortgage loan officers at state-chartered depository institutions (banks, credit unions, industrial banks and savings banks) to become licensed and subject to the Division of Real Estate's regulation. This regulation would include testing, continuing education and bonding.

The proposed provisions do not apply to national banks or federal credit unions. (See Commissioner Leary's article in this issue for a discussion on preemption.) The proposed removal of an existing exemption for state-chartered depositories would create an unfair advantage for federal institutions. The bill was "pulled" by its sponsor; however, there have been indications that the bill will be revisited during the 2005 session.~

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Utah Department of
Financial Institutions

Please contact
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